

**ASSEMBLY BILL**

**No. 229**

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**Introduced by Assembly Member Lara**

February 2, 2011

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An act to amend Section 12410.5 of, to add Sections 12410.6, 12410.7, and 12410.9 to, and to add and repeal Section 12410.8 of, the Government Code, relating to audits.

LEGISLATIVE COUNSEL'S DIGEST

AB 229, as introduced, Lara. The Controller: audits.

Existing law requires the Controller to superintend the fiscal concerns of the state. Existing law requires the Controller to receive every audit report prepared by any local public agency.

This bill would require the Controller to receive every annual financial audit report prepared by any local government within 9 months of the audit period or within a longer timeframe authorized by the Controller. This bill would require an audit conducted pursuant to this provision to fully comply with the Government Auditing Standards issued by the Comptroller General of the United States. This bill would require the audits to be made by a certified public accountant that is licensed by the California Board of Accountancy and selected by a local government. The Controller would be required to use specified criteria to determine those certified public accountants that are to be included in the directory.

This bill would require the Controller to develop a plan to review and report the financial and compliance audits of cities, counties, and special districts. This bill would also require the Controller to report to the Legislature by January 31 of each year the results of its oversight

activity. The requirement that the Controller report to the Legislature would be repealed on December 31, 2015.

Vote: majority. Appropriation: no. Fiscal committee: yes.  
State-mandated local program: no.

*The people of the State of California do enact as follows:*

1 SECTION 1. Section 12410.5 of the Government Code is  
2 amended to read:

3 12410.5. (a) The Controller shall receive every *annual*  
4 *financial* audit report prepared for any local ~~public~~ agency  
5 *government including those reports prepared* in compliance with  
6 the federal Single Audit Act of 1984 (P.L. 98-502; 31 U.S.C. Sec.  
7 7501 et seq.) and required under any law to be submitted to any  
8 state agency, and shall, after ascertaining its compliance with that  
9 federal act, transmit the report to the designated state agency.

10 (b) *It is the intent of the Legislature to promote accountability*  
11 *over local government funding by establishing a new program to*  
12 *review and report on financial and compliance audits of cities,*  
13 *counties, and special districts. It is further the intent of the*  
14 *Legislature that the Controller shall have the primary responsibility*  
15 *for implementing and overseeing the program. Financial audits*  
16 *provide an independent assessment of, and reasonable assurance*  
17 *about, whether an entity's reported financial condition, results,*  
18 *and use of resources are presented fairly in accordance with*  
19 *recognized criteria. Reporting on financial audits that are*  
20 *performed in accordance with government auditing standards also*  
21 *includes reports on internal control, compliance with laws and*  
22 *regulations, and provisions of contracts and grant agreements as*  
23 *they relate to financial transactions, systems, and processes.*  
24 *Compliance audits shall be defined in generally accepted auditing*  
25 *standards as a program-specific audit or an organization-wide*  
26 *audit or an entity's compliance with applicable compliance*  
27 *requirements. Financial and compliance audits conducted under*  
28 *this chapter shall fulfill federal single audit requirements.*

29 (c) *An audit conducted pursuant to this section shall comply*  
30 *fully with the Government Auditing Standards issued by the*  
31 *Comptroller General of the United States.*

32 (d) *The audits shall be made by a certified public accountant,*  
33 *licensed by the California Board of Accountancy, and selected by*

1 *the local government, as applicable, from a directory of certified*  
2 *public accountants deemed by the Controller as qualified to*  
3 *conduct audits of local governments which shall be published by*  
4 *the Controller not later than December 31 of each year. The*  
5 *certified public accountant shall possess individual education,*  
6 *examination, and experience qualifications that have been*  
7 *determined by the board to be substantially equivalent to the*  
8 *qualifications under Section 5093 of the Business and Professions*  
9 *Code, and that are in accordance with subdivision (b) of Section*  
10 *27 of Article 4 of Division 1 of Title 16 of the California Code of*  
11 *Regulations necessary to perform the full range of accounting*  
12 *services, including signing attest reports on attest engagements.*

13 *(1) In determining that certified public accountants shall be*  
14 *included in the directory, the Controller shall use the following*  
15 *criteria:*

16 *(A) The certified public accountants or public accountants, as*  
17 *a result of a quality control review conducted by the Controller*  
18 *pursuant to Section 12410.9, shall not have been found to have*  
19 *conducted an audit in a manner constituting noncompliance with*  
20 *subdivision (c).*

21 *(B) The certified public accountants or public accountants shall*  
22 *be in good standing as certified by the Board of Accountancy.*

23 *(2) It is the intent of the Legislature to ensure that auditors and*  
24 *audit organizations maintain their independence in appearance*  
25 *and in fact by rotation of public accounting firms. Beginning with*  
26 *the 2011–12 fiscal year, a local government shall be prohibited*  
27 *from using the same public accounting firm to perform an annual*  
28 *financial and compliance audit for more than five consecutive*  
29 *years. The Controller may waive this requirement if he or she finds*  
30 *that no qualified auditor is otherwise available to perform the*  
31 *audit.*

32 *(e) The governing board of each city, county, and special district*  
33 *shall include all of the following in their contracts for audits:*

34 *(1) A provision to withhold 10 percent of the audit fee until the*  
35 *Controller certifies that the audit report conforms to the reporting*  
36 *provisions of subdivision (a) of Section 12410.7.*

37 *(2) A provision to withhold 50 percent of the audit fee for any*  
38 *subsequent year of a multiyear contract if the prior year's audit*  
39 *report was not certified as conforming to the reporting provisions*  
40 *of subdivision (a) of Section 12410.7. This provision shall include*

1 *a statement that a multiyear contract shall be null and void if a*  
2 *public accounting firm or independent auditor is declared ineligible*  
3 *pursuant to subdivision (d) of Section 12410.9. The amount*  
4 *withheld shall not be payable unless payment is ordered by the*  
5 *board or the audit report for that subsequent year is certified by*  
6 *the Controller as conforming to the reporting provisions of*  
7 *subdivision (a) of Section 12410.7.*

8 *(3) A provision that will provide the Controller access to audit*  
9 *working papers.*

10 SEC. 2. Section 12410.6 is added to the Government Code, to  
11 read:

12 12410.6. (a) The Controller shall develop a plan to review and  
13 report on financial and compliance audits of cities, counties, and  
14 special districts. The Controller, in consultation with the  
15 Department of Finance, the Legislative Analyst's Office, state  
16 agencies, and representatives of the League of California Cities,  
17 the California State Association of County Auditors, and the  
18 California Society of Certified Public Accountants, shall propose  
19 the content of an audit guide.

20 (b) The audit reports shall be submitted to the Controller in  
21 accordance with Public Law 104-156 within nine months after the  
22 end of the period audited, or within a longer timeframe authorized  
23 by the Controller.

24 (c) If the audit reports required by subdivision (b) of Section  
25 12410.5 have not been filed by a local government with the  
26 Controller's office on or before the due date established under  
27 subdivision (b), the Controller's office shall determine the most  
28 advantageous method of obtaining the required audited financial  
29 statements.

30 SEC. 3. Section 12410.7 is added to the Government Code, to  
31 read:

32 12410.7. (a) To determine the practicability and effectiveness  
33 of the audits and audit guide, the Controller on an annual basis  
34 shall review and monitor the audit reports performed by  
35 independent auditors. The Controller shall determine whether the  
36 audit reports conform with the reporting provisions of subdivision  
37 (b) of Section 12410.9 and shall notify each local government, and  
38 the auditor of each local government regarding each determination.

39 (b) The independent auditor shall correct his or her audit report  
40 within 30 days of notification of any deficiency. The Controller

1 may suspend the independent auditor from performing any local  
2 government audits if the auditor does not correct his or her audit  
3 report within 30 days of the Controller's notification.

4 SEC. 4. Section 12410.8 is added to the Government Code, to  
5 read:

6 12410.8. (a) The Controller shall report to the Legislature by  
7 January 31 of each year the results of its oversight activity,  
8 including the results of its quality control reviews.

9 (b) A report submitted pursuant to subdivision (a) shall be  
10 submitted in compliance with Section 9795.

11 (c) Pursuant to Section 10231.5, this section is repealed on  
12 December 31, 2015.

13 SEC. 5. Section 12410.9 is added to the Government Code, to  
14 read:

15 12410.9. (a) The Controller may perform quality control  
16 reviews of audit working papers to determine whether audits are  
17 performed in conformity with government audit standards and the  
18 local government audit guide. The Controller shall communicate  
19 the results of his or her reviews to the Department of Finance, the  
20 independent auditor, and the local government for which the audit  
21 was performed, and shall review his or her findings with the  
22 independent auditor.

23 (b) Prior to the performance of any quality control reviews, the  
24 Controller shall develop and publish guidelines and standards for  
25 those reviews. Pursuant to the development of those guidelines  
26 and standards for those reviews, the Controller shall provide an  
27 opportunity for public comment. The Controller shall update the  
28 guidelines and standards for any changes in audit standards.

29 (c) The Controller is responsible for selecting audits for review  
30 based on criteria including, but not limited to, disciplinary actions  
31 by the California Board of Accountancy, results of the Controller's  
32 review and monitoring of the audit reports, the extent of findings  
33 in the audit reports issued by the independent auditor, the number  
34 of audits of local government performed annually by the  
35 independent auditor, the independent auditor's experience in  
36 performing audits of local governments, the complexity of state  
37 and federal programs administered by the local government, and  
38 requests or leads from other sources.

39 (d) If the quality control review of the Controller indicates that  
40 the audit was conducted in a manner that may constitute

1 unprofessional conduct as defined pursuant to Section 5100 of the  
2 Business and Professions Code, including, but not limited to,  
3 breach of fiduciary responsibility of any kind, gross negligence,  
4 repeated negligent acts resulting in a material misstatement in the  
5 audit or failure to disclose noncompliant acts, the Controller shall  
6 refer the case to the California Board of Accountancy. If the  
7 California Board of Accountancy finds that the independent auditor  
8 conducted an audit in an unprofessional manner, the Controller  
9 may prohibit the independent auditor from performing any audit  
10 of a local government for a period of three years, in addition to  
11 any other penalties that the California Board of Accountancy may  
12 impose. In any matter that is referred to the California Board of  
13 Accountancy, the Controller may suspend the independent auditor  
14 from performing any local government audit pending final  
15 disposition of the matter by notice and an opportunity to respond  
16 to that suspension. The independent auditor shall be given credit  
17 for any period of suspension if the California Board of  
18 Accountancy prohibits the independent auditor from performing  
19 audits of the local education agency under subdivision (c). In any  
20 event, the Controller shall not suspend an independent auditor  
21 under this subdivision for a period of more than three years.